RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 1, 1983 **LETTER 862**

May 20, DJIA 1189.92; PTI 1622; A-D Ratio –13.29
May 27, DJIA 1216.14; PTI 1632; A-D Ratio –12.79

THE MARKET: The market over the past week or so provided a classic study of a Dow Theory (downside) non-confirmation. The picture is shown clearly on the Wall Street Journal chart below. Note the flagrant downside non-confirmation by the Transports in the face of the decline by the Industrial Average below its 1204.33 low of May 2.

When we get this kind of non-confirmation during a primary bull market (particularly in the face of a record short interest) the implication is clear. Despite calls from all quarters for "a major correction," the Averages refused to confirm on the downside. Prognosis: the next direction of the market will be up.

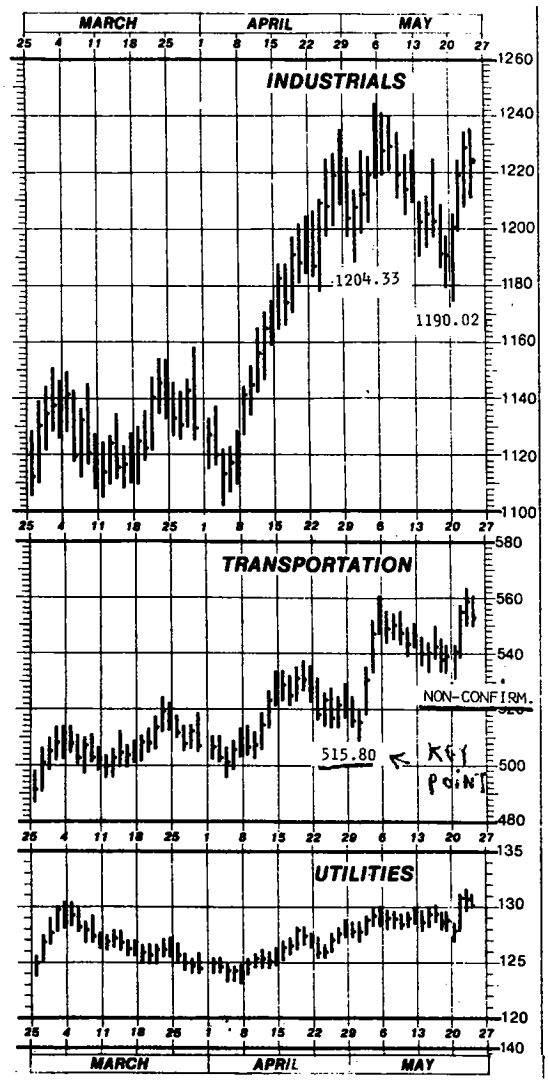
On May 25 the market exploded. On that day the D-J Transportation Average rose to a record high, the D-J Utility Average climbed to a bull market high, the A-D ratio hit a new high and the PTI recorded an all-time high. Confirmatory record highs were also struck by the Value Line, the NASDAQ, the AMEX and the NYSE Composite. The next day saw the D-J 65 Average and the S & P 500 Average strike record highs. It remained (in this long string of record highs) only for the Dow to better its May 6 peak of 1232.59.

But the extraordinary string of record highs attests to the power of this bull market. Nevertheless, a true primary bull market always gives you something to worry about. Today it's "Will the Dow confirm?" Tomorrow it may be "will the Utilities hold?" or "will the bonds fall apart?" And that's why I say, "Give the bull a lot of leeway. He's looking for ways of taking you out, scaring you out. And one of the ways is that he never looks perfect and he never gives you exactly what you want." For my money, however, he's given us PLENTY!

THE PICTURE: The stock market is the sternest of all masters. Yes, the market was conceived in the minds of men. Yes, the market is run by men (and women, of course). But the market can be likened to Frankenstein's monster–it's an invention of man which will gladly destroy him.

Nobody, no one can "tame" the stock market monster. And many have tried. Some men have studied the market through the avenue of "great values," others have used a strictly technical approach while still others have developed various and sundry trend-following techniques. Most people fail in the market, no matter what approach they use. And the reason is that the stock market is structured to make MOST PEOPLE fail. Sure, there are many big winners in the stock market, but the vast majority (over any reasonable length of time) will lose their money. The market is the world's most democratic place. It doesn't care if you are black or white, Christian or Jew, fat or slim, rich or poor. The market, in short, doesn't give a damn about you, your needs or your problems. Frankenstein turned on his master, and the stock market is perfectly capable of doing the same.

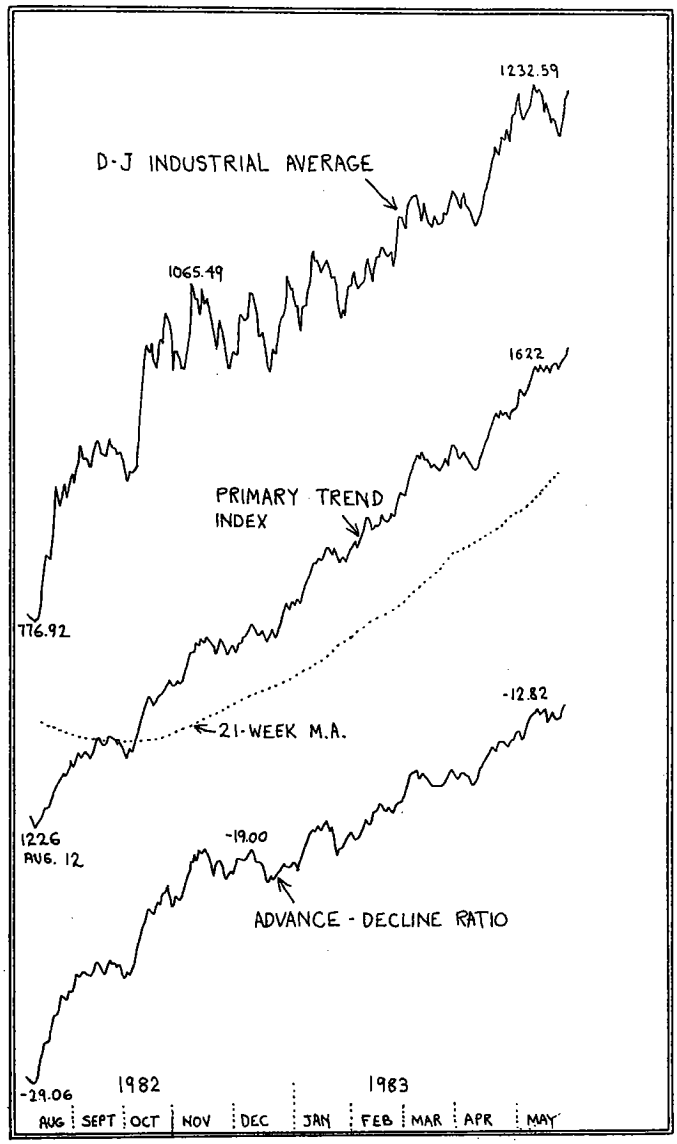
You can develop a system, and it may be a very good trading system. This system works beautifully, and six out of every ten



trades you make are profitable.So you really gain confidence in your system–and you go in BIG. You guessed it, the system stops working and you give all the marbles back. Why did the blasted system stop working just when you needed it? Don't ask questions, the answer is clear enough. The system didn't work when you needed it because you thought you had the almost-perfect system. The market was well aware of that, and it was just waiting to trap you, to prove you wrong. And it did. So back to square one for you (and in your heart you think maybe you'll give up all market systems and try fundamentals or the latest hot advisory).

But wait, let's not throw in the sponge. You can make money in the stock market (within reason). And there are a number of aids that you can use. Here are a few:

(1) Knowledge of how the market works, and this can take years. For many serious market practitioners, market knowledge is a *lifetime* endeavor (yes, I'm one of these).



"O.K., Russell," you retort. "You're intelligent enough to write all this stuff, and I'm paying you my hard-earned bucks to tell me about the market. So drop the philosophy and tell me about the market."

O.K., I'll tell you what I've been saying for a number of months. I think this is a big bull market, I think we're going to (ultimately) see a tremendous amount of public participation. I think that this market is different than any bull market we've seen in decades. And I believe the way to operate in this market is to "buy 'em and hold 'em."

I presented my list of defense stocks last February 25. Now you could have traded them, you could have jumped in and out, you could have switched back and forth from the cold ones to the hot ones and then back again. But I think you would have lost out. Those who bought the whole list in late February and did what I asked them to do (hold 'em) are up over 30% in three months. That's how the right stocks in the primary bull market work. They tend to rise like the tide of the ocean. But if you're a surfer (and I guess half the kids in La Jolla are) you're going to jockey around in the waves, take some and skip others, and you're going to be dumped by the first big wave. So my advice is, "Ride the bull market with a good list of stocks. And all in the knowledge that before the bull blows himself out, just about every stock is going to have to move. And that move is going to be UP."

(2) Experience. There's no substitute for experience in the market. But experience means time, and it also (sadly) means some losses. But you don't get your "street smarts" for nothing anywhere else, so why should you get them for free on Wall Street?

(3) Intuition. Not everybody has intuition about the stock market, but if you do you'll be way ahead of the game. I've met a number of people who have outstanding intuition about the market. But, and this is important, that intuition does NOT work all the time. You may get an intuitive flash once a year or (if you're lucky) three or four times a year. And that intuition may make a lot of money for you. But intuition on a daily or even weekly basis? Forget it, nobody's that blessed.

(4) Money. You've got to have the tools. And in this business, your basic tool is cash. You can be the greatest timer or stockpicker in the world, but if you don't have the bread, you aren't going to make the dough.

(5) Knowledge of self. Ah, this is a "biggie." I've written about this many times, but I'll repeat it for my many new subscribers. The market monster will search out your weakest area, and that's where he'll hit you. Greed, cowardice, laziness, stress, arrogance, ignorance, the market will make you rue the day that you didn't allow for your weakness. The market is a psychologist, and it will quickly show you your shortcomings. And you better get into and repair those shortcomings. Or you'll be unceremoniously knocked out of the box (unfortunately, you'll be poorer but probably not a bit smarter).

(6) Last, but not least, courage. You can have all kinds of theories, beliefs and convictions. But if you haven't got the guts to spend the money (or, for instance, sell out when a bear market begins) then all is for naught. Yes, you have to be able to "do it," to move. And that takes courage. But I will say this: Knowledge and experience can bolster your courage. There's nothing that bolsters courage as much as knowing what to expect.

Many advisers are saying that the excesses of the current stock market are a bearish indication. I don't agree. My feeling is that the so-called "excesses" in this market have major bullish implications. I owe many of the following observations to the very fine research department of Merrill Lynch.

(1) The plurality of advances over declines is currently showing the biggest gain since the early 1950s. (2) The annual rate of change in the Dow is close to the highest level since the early 1930s (when a huge bull market began). (3) The percentage of stocks above their 200-day moving averages has been at 89 or better for the last seven months. This hasn't happened since these figures were first computed eleven years ago. (4) The spread between the unweighted averages such as *Value Line* and *Indicator Digest* is the largest in twenty years (when these averages were first calculated). (5) Exchange volume is the largest in history. Each upward surge seems to bring in new records in volume. (6) The short interest on both the Amex and NYSE rose to record highs for mid-May. This is a bullish factor. It means that a record number of short sellers are playing for the decline–all this within the context of a primary bull market.

(7) The annual rate of change for the Dow is now in the 50% to 60% range. In the last 100 years the peak rate of change moved into this range only 10 times. In every previous case a final market proved to be six months to a year away–and in some cases it was longer.

Conclusion: We are witnessing a major secular rise in the stock market, not merely a cyclical rise. Something very big, very important is being signaled by the market.

My own opinion is that the current market surge (since August) resembles in many ways the power rises of 1932-33, 1942-44 or 1949-50. Those periods marked the start of major bull markets. Those rises occurred amid great gloom and amid very adverse economic conditions. The current rise stemmed from the same kind of base. But as I've stated before, the current rise should be the windup of the great primary bull force that grew out of the Depression. That rise began in July of 1932. The 1932-37 leg was the initial leg of the bull market. The current advance (beginning in 1982) is probably the final wave of the secular bull market. As such, it will include much more volume, much more speculation, much more excitement. The explosive quality of today's advance should be expected. It should be a different advance than 1932 or 1942 or '49. And it is.

INVESTMENT POSITION: We're riding out this primary bull market with no-load mutual funds, the defense stocks–and cash in the form of Treasury bills. For the conservatives, maybe 50% cash and 50% stocks is right. For the aggressive ones, maybe 75% stocks and 25% cash. For the hard money people, I don't recommend more than about 5% in gold at this time. That's because my gold to stocks ratio is saying in no uncertain terms that the relative strength is in stocks–not gold. If you load up on gold (rather than stocks) then you are spitting in the face of the markets. I don't recommend that.

SPECIAL COLUMN: The following guest column is included as a service to subscribers and readers everywhere. I also think the column provides background for my emphasis on selected defense stocks. This critically important piece was written by Melvyn Lippman specifically for this report. Lippman is publisher of US Organization Chart Service, Inc., an organization specializing in collecting, systematizing and distributing military and corporate data.

In talking with Lippman last week he informed me that he likens the US/Russian military situation to the US deficit problem. It's there, it's growing more threatening, and nobody is really addressing the situation. But he said that there is a major difference. The military situation (from the Russian build-up standpoint) is out of our hands. The deficit, at least, is within our ability to deal with. Thus, I continue to state that the great "shock of recognition" is coming. In my opinion, the Reagan five-year $1.5 trillion military build-up is not going to be enough. The US/Russian military gap is widening, and very, very few people take it seriously.

TODAY, – IN VIRTUALLY EVERY MEASURE OF MILITARY POWER, THE SOVIET UNION ENJOYS A DECIDED ADVANTAGE. Even as the US military has become more powerful, more effective, more efficient.

Our new anti-missile cruisers have more striking power, greater range and are manned by a crew of 319, while the cruisers they replace have less firepower, range and crews of 1,600. Equally, the Air Force during August 1944, as the Allied armies broke out of Normandy, some 3,000 heavy bombers of the 8th Air Force flew more than 18,000 strikes, something like 30,000 aircrew members were required for this effort. Today, 800 F-16 Fighters, manned by 800 pilots, can deliver the same tonnage of bombs over comparable distances and with more accuracy.

But, the Soviet military has become more powerful and more efficient than we. Approximately 75% of Soviet military personnel are conscripts. They spend about 17% of their military budget on personnel, we allocate some 60% of our defense budget for personnel. They spend twice as much as we do on research. Their armed forces outnumber us 2 to 1, they have a quantitative advantage over us in weaponry that in many cases approaches a 5 to 1 commanding lead. As this quantitative advantage continues to increase, the Soviet military has taken and is now in its next leap forward by establishing a decided qualitative lead. The soviet military research effort, a 2 to 1 lead, virtually assures them of overwhelming dominance in the military and weapons arena.

For many years now, and in all military areas the Soviet Union has been outspending, outresearching, outproducing and outdeploying the United States–in all military areas, conventional and nuclear in traditional and new weapons systems. Since our newest ICBM, the Minuteman III, which entered our force in the early 1970s, the Soviets have developed and deployed three new ICBMs, the SS-17s, SS-18s and SS-19s. Just recently they have begun flight testing a new solid propellant ICBM, yet another improvement to their overpowering ICBM forces. In the last several years alone, the Soviets have produced three types of sea-launched ballistic missiles and produced over 200 Backfire bombers. In addition, a new large Soviet bomber, the Blackjack A is undergoing light tests now. The Soviets outproduce the US by four to one in fighter aircraft and three to one in tanks. The Soviets produce a new fighter aircraft every several hours–the US produces one every several days. From 1976 - 1980 the Soviets turned out 13,500 tanks, more than our entire inventory.

Is there any sign that the Soviet military is changing? Yes. Ample evidence that the military buildup is continuing in all areas and increasing in some. Ample evidence that the Soviet Military is just beginning to be used outside the normal Soviet spheres to implement their 'national interests', economic and political.

I'm assuming at this time that my point has been made. And you may reply, "So what? What can we do about it? What might we expect in the next year or so? What can we expect by 1986 and beyond? What might the social, political and economic results of the massive Soviet build-up be?" Unfortunately, there is not adequate space to address these questions at this time.

But I can say, these are questions without good answers. The US position is bad and getting worse. We are going to experience losses without a bottom line. We are in extraordinary emergency, and we do not see it.. . . . yet?

DEFENSE STOCKS: Below is the latest rundown on our defense list. BDM split two for one, so in compiling the average of the ten stocks I will double the price of BDM.

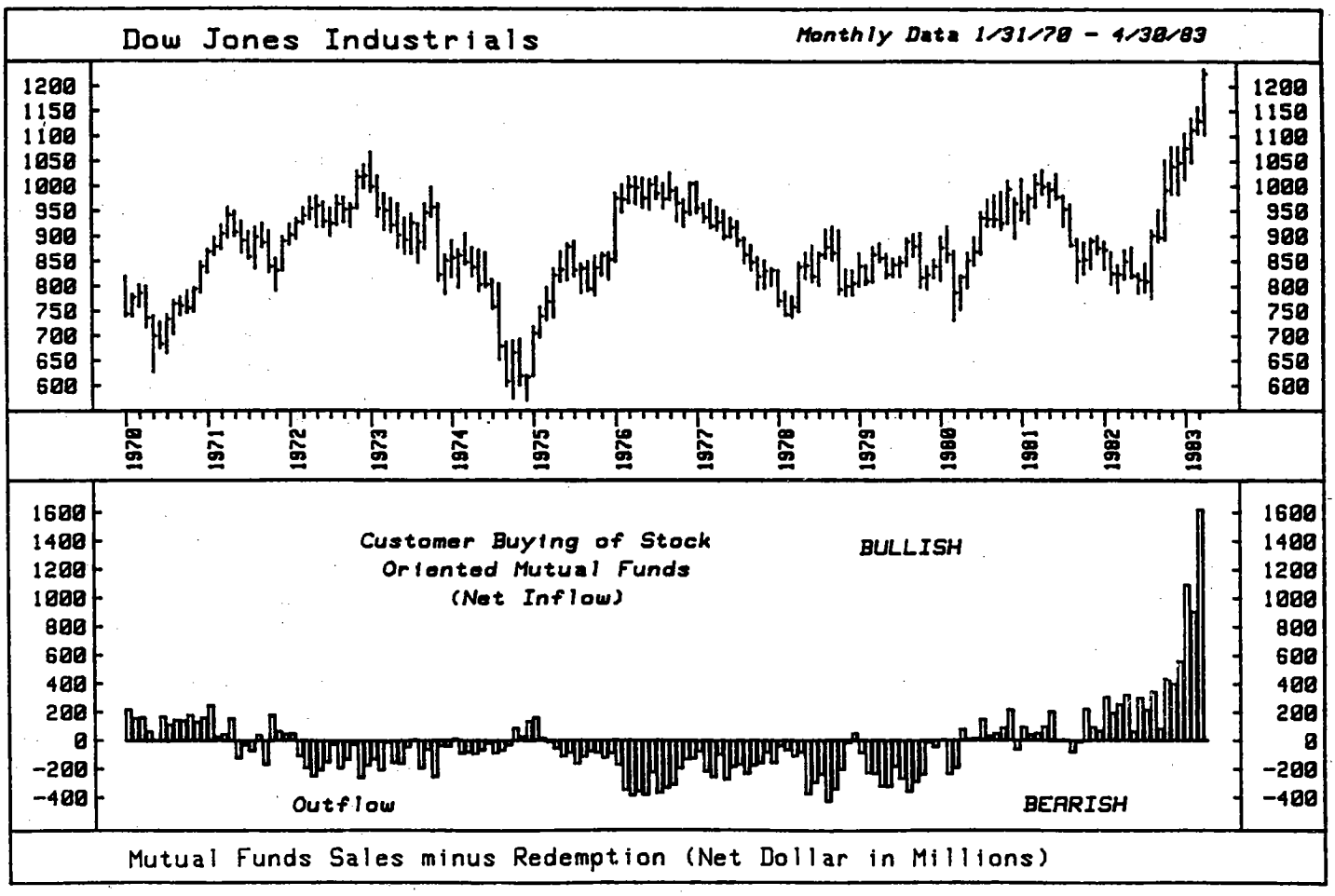
I am adding three more defense-oriented stocks to the list. They are American Science and Engineering (ASE), Varo (NYSE) and Electronic Associates (NYSE). The three new stocks will be added to the list and I will use a divisor to adjust for the new additions.

		2/25/83 Price	Current Price	
NYSE	Harris Corp. (HRS)	49 1/2	44	Defense stock average based on 1 share of each this week is 337
NYSE	LFE (LFE)	11 7/8	15 3/4	
NYSE	Planning Research (PLN)	14 3/8	20 1/8	
NYSE	Scientific Atlanta (SFA)	19	19 3/8	
NYSE	Tracor (TRR)	28 3/4	33 5/8	
NYSE	Bolt Beranek (BBN)	37	68	
NYSE	BDM (BDM)	43 1/2	87	
AMEX	Dynalectron (DYN)	12 3/4	14 1/2	
AMEX	Moog B (MOGB)	15 1/2	21 1/2	
AMEX	Systems Planning (SPZ)	7	12 7/8	up 41% from Feb 25
	Original purchase date Feb. 25 '83		239	

THE PUBLIC: In Letter 859 I presented the case for this segment of the market being the windup of the entire primary rise which started in July, 1932. Most of the people investing or trading in stocks have never seen the entrance of the public. They have never seen true, bona fide public participation. I want to warn subscribers that the entrance of the public (contrary to what is popularly believed) does NOT signal the end of a bull market. The public can buy for months on end, even for a few years, before the bull market becomes heavy and tumbles over.

I note that the odd-lot (under 100 shares) public has been selling steadily for years, but of late their selling has been more subdued. I believe that before this bull market is over we will see many months in which the odd lot public will be buyers on balance. That has not even begun yet.

Now comes a chart from *Ned Davis Research* (PO Box 2089, Venice, FL 33595), which shows a vastly changed picture on the part of the stock oriented mutual fund buyers. After selling funds on balance ever since 1972, there was a subtle change during 1981 and 1982 (sporadic buying). But as 1982 progressed and 1983 entered, the public started buying mutual funds in earnest. In fact, the 1983 buying has been the heaviest for mutual funds in well over a decade.



My expectation is that before this bull market is over, before the final wave has spent itself, we will see a concerted and long-lived move by the public into the stock market. My guess is that we will see more public buying than at any time in stock market history. So far, the hints are there, but I feel that there is still a good deal of caution (as witnessed with the continued preoccupation with "the coming reaction").

NOTES & QUOTES: The May 27 *London Economist* contains a remarkable section on the advances in military technology. "The miniaturization of electronics has been by far the most significant military development of the past two decades" says the Economist. Electronic components have become smaller, more rugged, cheaper and more reliable. In the mid-1960s, memory devices cost about 3-5 cents per bit. They now cost less than one-thousandth of a cent per bit. "If motor cars had evolved in the same way as military electronics over the past two decades, a Rolls-Royce would now be 1.5 inches long and cost $3.25."

Among new developments in military technology: stealth aircraft that can't be detected by radar, computer-guided torpedoes, new armour for tanks that make them invulnerable to almost all infantry weapons, a caseless cartridge that weighs less than half the standard small arms cartridge and allows the new H & K rifle to fire devastating clusters of three bullets. Missile and drones now (due to microelectronics) pack all the information formerly contained only in fighter planes. Missiles can outperform manned aircraft; they go faster and turn more rapidly. The ground forces due to PLRS (position locating and reporting) can fix the position of units in the field with great accuracy, something impossible only a few years ago.

* *

To me, a book is worth reading if I can get a single good idea or concept from it. A few days ago I read a book entitled, "How To Be Your Own Best Friend" by Newman and Berkwitz (Ballantine soft cover, $2.25). The book contained a lot of excellent ideas, but the one that fascinated me had to do with being wrong. I've always maintained that the stock market is the toughest of all schools. The market will attack you where you are weakest and where you need the most work (examples, your ego, your greed or your lack of courage).

At any rate, here's a passage from the book on the simple subject of being wrong and what to do about it. I think it is highly instructive. "You'd be surprised. Being right is one of the most satisfying experiences in the world. Or let's say, rather, that being wrong is one of the most unsettling experiences that can happen to anyone. It's an awful blow to the ego to feel you've made a mistake. That's why people don't want to change. A patient once burst out at me indignantly, 'But that would mean I wasted the first forty years of my life!' Some people would rather go on making the same mistake for another forty years than admit it and cut their losses. People are very stubborn. Sometimes they secretly believe that if they keep on long enough with their misconceived behavior, they'll make it right. That reality will give in to their views, rather than vice versa. They're still trying to get their parents to give in. They haven't given up their anger over what they didn't get when they were five years old.

People feel very justified in that anger: they can give you all the details on how unfairly they were treated. They are usually right; they did get cheated as children. But what they don't see is that they are now cheating themselves as adults. As long as they spend their energies being angry at the people who deprived them once, they won't spend their efforts on getting for themselves what they need now. Their rage isn't hurting their parents, but it's crippling them."

Russell, you ask, do you really think that rage and stubbornness (based on inequities in the past) can have something to do with being stubborn and losing money in the stock market? My answer is–you bet I do. I often think that people are fighting old battles when they refuse to admit they are wrong in the stock market. And the sad part is that the market couldn't care less. It will grind those stubborn people under like wheat under a millstone.

* *

From our "Could You Do This?" Dept: Sen. Lawton Chiles stated recently that "We have entered into the era of the imperial form presidency." US News & World Report revealed that Jimmy Carter charged off (last year) office expenses of $292,000. But that's O.K., because Jerry Ford (remember him) ran up $249,000 in tax paid expenses. Not to be outdone, Richard Nixon spent $236,000 including $62,000 in annual office rent in a Manhattan Federal building. Yes, presidents take a beating in office, but it isn't half-bad afterwards.

* *

What's in a hot movie? A lot, if you look at MCA. Due mainly to E.T.'s unbelievable success, MCA ended 1982 with $400 million in its piggy bank.

Past performance doesn't guarantee anything in this business. But in case you are interested, the best investments over the past five years were (1) coins, where $10,000 grew to $41,000. (2) Growth stocks $10,000 to $27,000. (3) OTC stocks to $25,000. (4) Silver to $23,000. (5) Growth & income funds to $23,000.

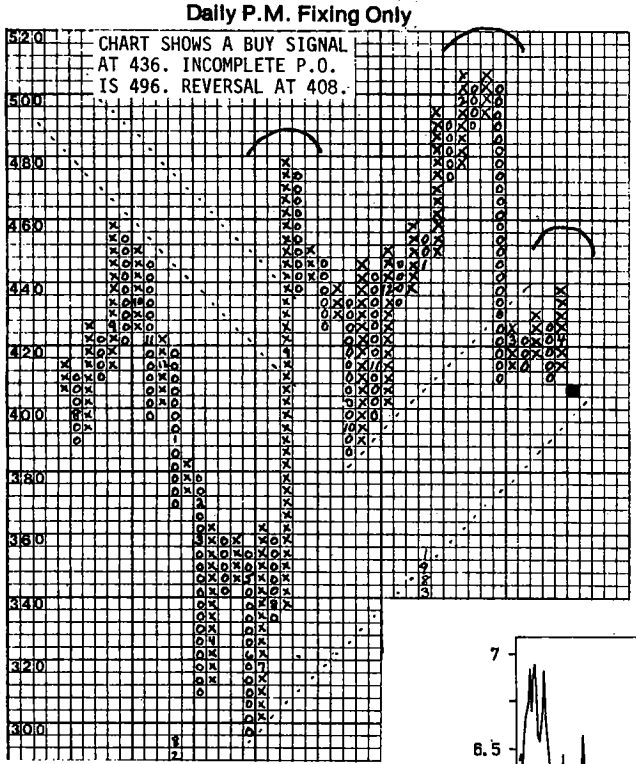
Over the past one year the number one investment was (1) silver where $10,000 grew to $15,000, (2) OTC stocks to $14,000 (3) GNMA Pass through Bonds to $14,000, (4) Growth funds to $14,000, (5) Corporate bonds to $14,000.

GOLD: I'm not sure, but I think the only "hard-money" adviser (besides myself) who has not been bullish on gold is my old friend, Harry Browne. In his latest report (out of Box 5586, Austin, TX 78763) Harry makes fun of the fact that Investors and newsletter writers think they are so much smarter than anyone else. And what does Harry say about we hard-money people? Read below:

> **If investors and newsletters in general are condescending in this way, hard-money investors and newsletters can be positively insufferable. After all, we've proven our superiority by being part of the great hard-money bull markets of the 1970s while others were losing money in stocks, bonds, and bank accounts. If any group of people has proven itself to be God's remnant, it is we.**

We're the only people who understand the connection between the money supply and inflation, the only people who understand gold, the only people who understand that there are economic problems in the world, the only people with a view of the world that translates into investment profits, the only people who know that to make a fortune in the 1980s one must do what made a fortune in the 1970s — invest in gold and silver.

Although I understand how comforting it is to feel superior, I also know that vanity isn't going to make me a dime in the 1980s. As an investor, I not only have to feel comforted, I have to make the right investments. And as an advisor, no matter how many times I tell you how smart I am, you'll still abandon me if I don't prove that I'm right.



The gold holders have been sitting for months now–and it's cost them money to sit. The spot price of gold has been creaking down, and I would think that anything under 430 could set off stop loss orders and increased selling.

To my mind, gold is definately looking somewhat toppy here. This point & figure chart (courtesy of Chartcraft, Larchmont, NY) shows that the critical downside point for gold is 408 (the black box on the chart). If 408 is hit, I think we could see a serious break in gold down to the 350-380 level.

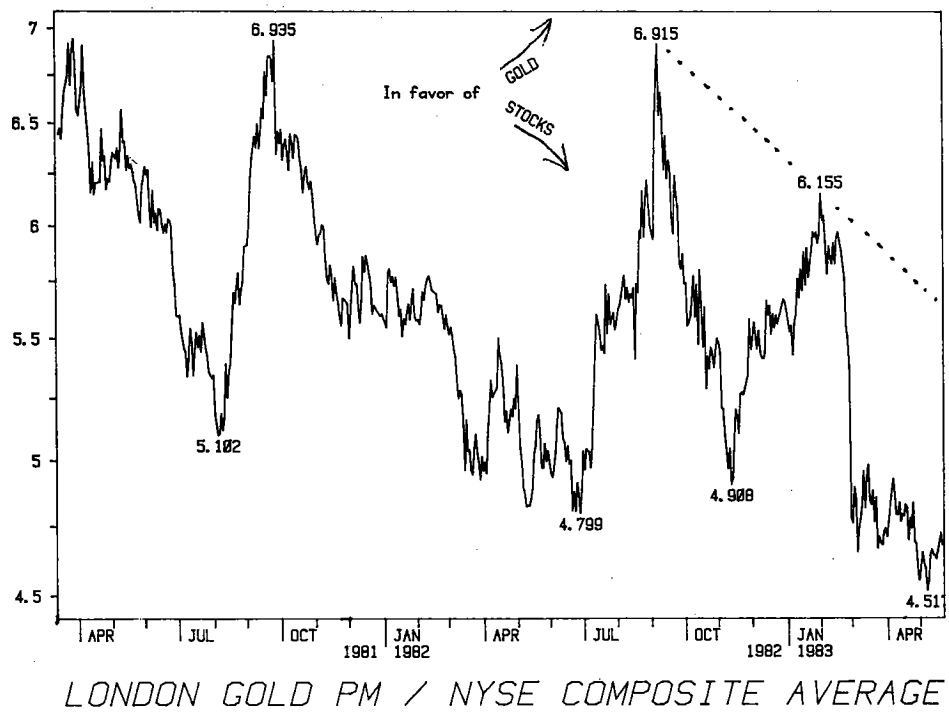
The second chart (computerized, courtesy of subscriber John Carder) is an up-dated ratio chart showing the gold price divided by the NYSE Composite. This is actually a relative strength chart which indicates whether gold or common shares are the stronger. The Ratio this month dropped to a new multi-year low of 4.51. This, of course, constitutes a negative background for gold. It tells us that the money has been moving towards the stock market and that this is where investors' preferences lie. This trend in favor of common stocks has been in force ever since early 1980. It is exceedingly pronounced now.

LATE NOTES: With the stock market in a shake-out phase, watch the Transportation Average–which has not been willing to confirm any Industrial weakness. The key point for Transports (see page 1 chart) is 515.80. A persistent refusal to break that level will be bullish.

GOLD: I would consider any London fix below 428 as bearish. Gold looks shaky here (and I've felt that for some time). A gold fix at 428 would suggest a testing of 400.

	Dow	PTI	Gold
Current	1216	1632	437
5-wk MA	1209		437
13-wk MA	1174		438
50-wk MA	1050		428
3-wk MA		1626	
8-wk MA		1600	
21-wk MA		1539	

NEXT MAILING: June 15



LONDON GOLD PM / NYSE COMPOSITE AVERAGE